



EAT =

Buyer =

Dear :

This is in response to your request for a ruling dated July 30, 2007, and submitted by your authorized representatives on behalf of the Trust. Specifically, a ruling has been requested that the termination of LLC under § 708(b)(1)(B) of the Code resulting from the distribution of Trust assets pursuant to the Termination Plan will not preclude the Replacement Property from being held for investment or for the productive use in a trade or business within the meaning of § 1031(a).

### FACTS

Trust was established as a private testamentary trust by Decedent's will upon his death in Year 1 to administer his assets and to provide income to its beneficiaries. At the present time, Trust has real property assets located in numerous states. All of the Trust's directly-owned properties are held for investment purposes. Trustees of Trust created an operational structure through which Trust engaged in various real estate investment activities. This operational structure included LLC, which is owned y percent by Trust, with the remaining percentage owned by Corporation, which is itself wholly owned by Trust. The real estate investment activities carried out by LLC include like-kind exchanges of real estate investment properties.

Under the terms of Decedent's will, Trust terminated at midnight on Date A. Prior to Date A, Trustees formulated a Termination Plan, which outlined a plan and mechanism for distributing Trust's assets to its remainder beneficiaries upon termination. State A Probate Court approved Termination Plan on Date B. Under Termination Plan, Trust assets equal to w percent of the remainder beneficiaries' stirpital interests were distributed in cash and through in-kind distribution to certain remainder beneficiaries. The remaining Trust assets equal to x percent of the remainder beneficiaries' stirpital interests was contributed by Trustees prior to termination to Successor Entity. The assets contributed to Successor Entity included Trust's y percent membership interest in LLC and its 100 percent stock interest in Corporation. Upon termination of Trust, all shares of Successor Entity were distributed among certain (but not all) remainder beneficiaries. Successor Entity is intended to continue Trust's real estate investment operations on a going forward basis consistent with past practice, with much of the same managerial and operational structure remaining intact.

Trustees have determined that it is prudent for LLC to dispose of Relinquished Property in an exchange that will meet the requirements for like-kind exchange treatment under

§ 1031. As replacement property, it was determined that LLC should acquire a  $\underline{z}$  percent interest in Replacement Property. The acquisition of Replacement Property and the disposition of the Relinquished Property were structured as a reverse like-kind exchange pursuant to Rev. Proc. 2000-37, 2 C.B. 308. On Date C, Trust entered into a contract for the purchase of Replacement Property from Seller. On Date D, Trust assigned a  $\underline{z}$  percent interest in the purchase contract to LLC; LLC immediately assigned the entire  $\underline{z}$  percent interest to DE, a disregarded entity whose sole member was EAT. On the same date, LLC entered into a Qualified Exchange Accommodation Agreement with EAT, pursuant to which EAT agreed to act as exchange accommodation titleholder within the meaning of Rev. Proc. 2000-37 with respect to Replacement Property. Seller transferred title to a  $\underline{z}$  percent interest in Replacement Property to DE on Date D.

On Date E, LLC entered into a contract for the sale of Relinquished Property to Buyer. On Date F, LLC and EAT entered into an Exchange Agreement pursuant to which EAT agreed to act as qualified intermediary with respect to Relinquished Property. On Date G, LLC assigned its rights under the contract for sale of Relinquished Property to EAT. On Date H, LLC directly deeded Relinquished Property to Buyer. EAT then assigned the membership units in DE to LLC to complete the exchange.

The submission states that LLC has at all times intended to hold the Replacement Property solely to generate additional rental income and has no plans whatsoever to develop or construct any improvements on such property or to sell Replacement Property or any portion thereof at any time. It has continued to own this property for investment purposes and has continued to manage it in precisely the same way. There has been no change in the beneficial ownership of LLC.

On Date I, pursuant to the Termination Plan, the Trust distributed all of its shares in Successor Entity, which then held almost all of the Trust's real estate and other investment operation assets, including its interests in LLC, to its remainder beneficiaries. Under Rev. Rul. 99-5, 1999-1 C.B. 434, the distribution of the shares to the remainder beneficiaries is treated as a distribution of Trust's assets followed by a recontribution of those assets by the remainder beneficiaries to Successor Entity. Because assets held by Successor Entity include a greater than 50 percent interest in LLC, this distribution and deemed recontribution of the shares resulted in a § 708(b)(1)(B) termination of LLC. In a § 708(b)(1)(B) termination, LLC is deemed to have contributed its assets to a new partnership in exchange for an interest in the new partnership, and then to have made a liquidating distribution of that new partnership interest to its members. Treas. Reg. § 1.708-1(b)(4).

The Trust makes the following representations:

- (1) The Relinquished Property was held by LLC for investment purposes at all times during its ownership thereof;

- (2) The disposition of the Relinquished Property and the acquisition of the Replacement Property was accomplished in a manner that in all respects, aside from the issues raised in this ruling request, qualify the transaction as tax-free exchange within the meaning of § 1031 and the regulations thereunder; and
- (3) The Replacement Property was “like kind” to the Relinquished Property for purposes of § 1031 and was held by the LLC for investment purposes, aside from the issues raised in this ruling request. In addition, Trust represents that there was a valid “exchange” of property under the reverse exchange safe harbors of Rev. Proc. 2000-37.

### LAW AND ANALYSIS

Section 1031(a)(1) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of a like kind which is to be held either for productive use in a trade or business or for investment. Under § 1.1031(a)-1(b) of the Income Tax Regulations relating to the meaning of the term "like kind," real property is generally considered to be of like kind to all other real property, whether or not any of the real property involved is improved or unimproved.

Section 1031(a) contains a “holding” requirement, that is, both the relinquished property and the replacement property must be held either for productive use in a trade or business or for investment. As stated above, you have requested a ruling that the Replacement Property will not be precluded from being held for investment or for the productive use in a trade or business within the meaning of § 1031(a) because of the termination of LLC under § 708(b)(1)(B) resulting from the distribution of Trust assets pursuant to the Termination Plan.

In Rev. Rul. 75-292, 1975-2 C.B. 333, an individual taxpayer in a prearranged transaction transferred land and buildings used in the taxpayer's trade or business to an unrelated corporation in exchange for land and an office building owned by the corporation and used in its trade or business. Immediately thereafter, the individual taxpayer transferred the land and office building to the individual's newly created corporation in exchange for the stock of the same corporation in a transaction that qualified for nonrecognition of gain under § 351. Rev. Rul. 75-292 concludes that the individual taxpayer did not exchange the real estate for other real estate to be held either for productive use in a trade or business or for investment by that taxpayer but that the taxpayer acquired the replacement property for the purpose of transferring it to the new corporation. As a result, the exchange did not qualify for nonrecognition under § 1031.

In Rev. Rul. 77-337, 1977-2 C.B. 305, in a prearranged plan, an individual taxpayer liquidated all of the stock of a corporation and transferred the corporation's sole asset, a shopping center, to a third party in exchange for like-kind property. Rev. Rul. 77-337

noted that under Rev. Rul. 75-292, a newly created corporation's eventual productive use of property in its trade or business is not attributable to its sole shareholder. Consequently, the individual taxpayer did not hold the shopping center for use in a trade or business or for investment because the corporation's previous trade or business use could not be attributed to its sole shareholder, and the exchange did not qualify for nonrecognition of gain or loss under § 1031.

Section 1031 was designed, in part, to postpone the recognition of gain or loss when property used in a trade or business or held for investment is exchanged for other property in the course of the continuing operation of that trade or business, or in the course of investment. In those circumstances, the taxpayer has not received any gain or suffered any loss in a general and economic sense, nor has the exchange of property resulted in the termination of one venture and assumption of another. The business venture operated before the exchange continues after the exchange without any real economic change or alteration, and without realization of any cash or readily liquefiable asset. See Carlton v. United States, 385 F.2d 238 (5th Cir. 1967); Jordan Marsh Co. v. Commissioner, 269 F.2d 453 (2 Cir. 1959); cf. Portland Oil Co. v. Commissioner, 109 F.2d 479 (1 Cir.) cert. den., 310 U.S. 650 (1940). See generally § 1.1002-1(c) (“[t]he underlying assumption of these exceptions [e.g., § 1031] is that the new property is substantially a continuation of the old investment still unliquidated”).

In this case, Trust terminated involuntarily by its own terms after many years in existence. Because Trust was a testamentary trust, the termination date was fixed by Decedent and could not be modified or changed. The Plan of Termination was approved by the State A Probate Court and would have occurred without regard to whether this exchange of properties had been consummated. Consequently, the like-kind exchange in this case was wholly independent from termination of Trust, and thus LLC's acquisition of the Replacement Property in a reverse like-kind exchange was wholly independent of its § 708(b)(1)(B) termination. Moreover, there has been no change either in the beneficial ownership of LLC, or in the way it holds or manages the Replacement Property. It has continued to own this property for investment purposes. Thus, the facts in this ruling request are distinguishable from those in Rev. Rul. 75-292 and Rev. Rul. 77-337, which involve voluntary transfers of properties pursuant to prearranged plans.

We therefore conclude that the termination of LLC under § 708(b)(1)(B) resulting from the distribution of Trust assets pursuant to the Termination Plan will not preclude the Replacement Property from being held for investment or for the productive use in a trade or business within the meaning of § 1031(a).

No determination is made by this ruling letter as to whether the described transaction otherwise qualifies for deferral of gain realized under § 1031. We express no opinion, except as specifically ruled above, as to the federal income tax treatment of the transaction under any other provisions of the Code and regulations that may be

applicable or under any other general principles of federal income taxation. Neither is any opinion expressed as to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction(s) that are not specifically covered by the above ruling.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

William A. Jackson  
Branch Chief, Branch 5  
Office of Chief Counsel  
(Income Tax & Accounting)